Alberta

2013-14 **Second Quarter** Fiscal Update and Economic Statement

The **Building Alberta** Plan

November 2013

Table of Contents

ACTUAL RESULTS 3

Operational Plan Highlights 4

Operational Plan Summary 4

Revenue 5

Operating Expense by Ministry 6

Disaster / Emergency Assistance 6

Capital Amortization 7

Inventory Consumption 7

Debt Servicing Costs 8

2013-14 Financing Requirements 8

Inventory Acquisition 8

Capital Plan Highlights 9

Capital Plan Summary 9

Capital Plan by Ministry 9

ECONOMIC OUTLOOK

Population surges as strong expansion continues 10

REVENUE IMPACTS

Impact of recent developments on government revenue 13

GLOBAL ECONOMY

The global recovery forever on the horizon 14

NOTE: Amounts presented in tables may not add to totals due to rounding.

Alberta

#BuildingAlberta BuildingAlbertaPlan.ca

ADDITIONAL COPIES OF THIS REPORT
may be obtained by visiting our website at: www.finance.alberta.ca/publications/budget/index.html

ACTUAL RESULTS

For the first six months of 2013–14

Method of Consolidation

The *2013-14 Second Quarter Fiscal Update and Economic Statement* reports on the same scope, using the same method of consolidation, as presented in *Budget 2013*.

The results of all government departments, funds and agencies, except those designated as government business enterprises, are consolidated on a line-by-line basis. Revenue and expense transactions between consolidated entities have been eliminated.

The accounts of provincial agencies designated as government business enterprises are included on the modified equity basis, the equity being computed in accordance with International Financial Reporting Standards applicable to those entities.

The accounts of the Alberta Innovates corporations and the Crown-controlled SUCH sector organizations such as school boards, universities, colleges, technical institutes, and Alberta Health Services that are controlled by the government are not included in this fiscal summary. These Crown-controlled entities are consolidated on a line-by-line basis in the consolidated financial statements forming part of the *Government of Alberta Annual Report*.

Basis of Financial Reporting

The consolidated fiscal summary reports revenue (including gains from disposal of tangible capital assets), expense (including amortization, loss on disposal and write-down of tangible capital assets), and surplus / (deficit).

Revenue and expense are recorded using the accrual basis of accounting. Cash received for goods or services which have not been provided by period end is recorded as unearned revenue.

Transfers received for capital purposes, and donated capital assets, are recorded as revenue as the cash is used to acquire capital assets and the donated assets are added to the balance sheet. The accounting policy followed in the Consolidated Financial Statements is to record a "deferred capital contribution," similar to a liability, when the cash or asset is received, and to recognize the revenue over the related asset's useful life (in effect matching the asset's amortization expense).

Expense includes the province's cash payments towards the unfunded pension liabilities. Expense excludes the change in the unfunded pension liabilities, which is a non-cash expense that does not affect borrowing requirements.

Debt servicing costs include interest payable, and amortization of issue costs and discounts / premiums on debt issues.

Compliance with Legislation

The *Fiscal Management Act* requires reporting on the actual results of the fiscal plan for the first six months of the fiscal year (April 1 to September 30), on or before November 30. The Act gives the President of Treasury Board and Minister of Finance discretion over the form of the report.

The *2013-14 Second Quarter Fiscal Update and Economic Statement* provides comparisons between the six month estimates and actual results for: revenue and operational expense; the operational surplus / (deficit); the Capital Plan: financing (borrowing) requirements. Also included are an estimate for the year-end balance of the Contingency Account, to indicate the Province's net financial position, and updated Alberta and global economic outlooks, with associated assumptions.

Under the *Fiscal Management Act*, operating expense increases, excluding those for dedicated revenue-operating expense, collective bargaining or other remuneration settlements, or settlements with First Nations, are limited to 1% of total budgeted ministry operating expense. Actual operational expense for a fiscal year also cannot exceed operational revenue plus any amounts allocated from the Contingency Account.

This report, and results for the first six months of 2013-14, are in compliance with the requirements of the *Fiscal Management Act*.

Operational Plan Highlights

Actual results for the first six months of 2013-14 produced an operational surplus of $1.1 billion, $1.1 billion higher than the *Budget 2013* estimate, due to a $1.4 billion increase in operational revenue, partially offset by a $244 million increase in expense.

Operational Revenue for the first six months was $20,347 million, $1,381 million higher than expected.

- Resource revenue was $4,482 million, $960 million higher, mainly due to higher oil prices, partly offset by lower natural gas prices and land lease sales.
- Heritage and endowment fund investment income was $310 million greater, due to strong equity markets.
- Personal income tax revenue was $153 million higher, due to increased 2012 tax year assessments and strong population growth.
- Other notable revenue variances after six months include: increases of $52 million in agriculture insurance premiums, $50 million in investment management fees, and $31 million in net liquor income; and decreases of $306 million in corporate income tax, due to timing of instalments, $64 million in federal infrastructure transfers, mainly due to slower-than-expected municipal applications, and $43 million in miscellaneous revenue, mainly from lower Fort McMurray land sales.

Operational Expense for the first six months was $19,271 million, $247 million higher than expected, due primarily to increased disaster / emergency assistance for flooding.

- Operating expense was $134 million lower than expected, mainly from delayed grants to Alberta Health Services, partly offset by increases relating to timing of grants for policing and to school boards, and for social programs, crude oil marketing costs, agriculture indemnities and external investment management fees.
- Disaster / emergency expense was $443 million higher than expected, due to the provision of $351 million for flood assistance and to increased forest fire-fighting costs.

The Contingency Account balance on September 30, 2013 was $2,413 million, and by year end the balance is estimated at about $2.5 billion. The 2013-14 year-end operational results could range from a surplus of $250 million to a deficit of $250 million. The six month results include only a small portion of expected flood assistance expense, but no expected disaster recovery federal revenue.

OPERATIONAL PLAN SUMMARY[a]

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Total Revenue	**38,732**	**19,451**	**20,737**	**1,286**	**18,950**	**1,787**
Less:						
Revenue received for capital purposes	(522)	(217)	(162)	55	(165)	3
Investment income retained by Heritage Fund	(297)	(149)	(133)	16	(125)	(8)
Allocation for Capital Plan debt servicing costs	(238)	(119)	(95)	24	(68)	(27)
Operational Revenue	**37,675**	**18,966**	**20,347**	**1,381**	**18,592**	**1,755**
Operational Expense						
Operating expense	36,942	18,326	18,192	(134)	17,573	619
Less in-year savings	(400)	-	-	-	-	-
Net operating expense	**36,542**	**18,326**	**18,192**	**(134)**	**17,573**	**619**
Disaster / emergency assistance	200	15	458	443	487	(29)
Amortization / inventory consumption / loss on disposals	982	483	441	(42)	411	30
General debt servicing costs	402	200	180	(20)	182	(2)
Total Operational Expense	**38,126**	**19,024**	**19,271**	**247**	**18,653**	**618**
Operational Surplus / (Deficit)	**(451)**	**(58)**	**1,076**	**1,134**	**(61)**	**1,137**

[a] For fiscal policy purposes under the *Fiscal Management Act*. Does not include revenue or expense of Crown-controlled SUCH sector organizations or Alberta Innovates corporations, or changes in pension liabilities. 2013-14 Budget revenue and operating expense have been increased by $120 million, reflecting changed accounting policy for an allowance for doubtful accounts for corporate income tax, now included in expense instead of being deducted from revenue. 2012-13 six month Actual revenue and operating expense have been increased by $18 million, reflecting changed accounting policy for crude oil transportation and marketing costs, now included in expense instead of being deducted from crude oil royalty revenue.

REVENUE

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Income Taxes						
Personal income tax	10,001	5,000	5,153	153	4,591	562
Corporate income tax	4,943	2,412	2,106	(306)	1,994	112
	14,944	**7,412**	**7,259**	**(153)**	**6,585**	**674**
Other Taxes						
Education property tax	1,835	918	921	3	875	46
Tobacco tax	920	460	483	23	478	5
Fuel tax	900	450	450	-	420	30
Insurance taxes	333	167	179	12	158	21
Freehold mineral rights tax	152	76	70	(6)	67	3
Tourism levy	85	43	45	2	42	3
	4,225	**2,114**	**2,148**	**34**	**2,040**	**108**
Non-Renewable Resource Revenue						
Bitumen royalty	3,367	1,540	2,644	1,104	2,238	406
Crude oil royalty	1,615	851	1,201	350	955	246
Natural gas and by-products royalty	965	497	192	(305)	288	(96)
Bonuses and sales of Crown leases	1,148	556	351	(205)	579	(228)
Rentals and fees	145	73	87	14	86	1
Coal royalty	10	5	7	2	(8)	15
	7,250	**3,522**	**4,482**	**960**	**4,138**	**344**
Transfers from Government of Canada						
Canada Health Transfer	2,597	1,298	1,317	19	1,144	173
Canada Social Transfer	1,374	687	686	(1)	652	34
Agriculture support programs	319	213	225	12	181	44
Labour market agreements	174	87	97	10	99	(2)
Infrastructure support	370	154	90	(64)	119	(29)
Other	281	140	133	(7)	151	(18)
	5,115	**2,579**	**2,549**	**(31)**	**2,346**	**203**
Investment Income						
Alberta Heritage Savings Trust Fund	1,368	684	948	264	653	295
Endowment funds	234	117	163	46	115	48
Alberta Capital Finance Authority	279	140	139	(1)	167	(28)
Contingency Account	63	32	37	5	108	(71)
Agriculture Financial Services Corporation	124	58	57	(1)	55	2
Other	77	39	43	4	69	(26)
	2,145	**1,070**	**1,387**	**317**	**1,167**	**220**
Net Income from Government Business Enterprises						
AGLC - Gaming / lottery	1,484	742	734	(8)	753	(19)
AGLC - Liquor	718	359	390	31	382	8
Alberta Treasury Branches	250	125	140	15	113	27
Other	26	13	15	2	14	1
	2,478	**1,239**	**1,279**	**40**	**1,262**	**17**
Premiums, Fees and Licences						
Motor vehicle licences	485	239	245	6	232	13
Crop, hail and livestock insurance premiums	313	310	362	52	308	54
Energy industry levies	203	194	180	(14)	138	42
Land titles	85	42	45	3	45	-
Land and grazing	69	35	37	2	32	5
Supplementary health benefits premiums	53	27	25	(2)	27	(2)
Other	364	180	189	9	135	54
	1,572	**1,027**	**1,083**	**56**	**917**	**166**
Other						
AIMCo investment management charges	167	84	134	50	112	22
Fines and penalties	126	63	74	11	69	5
Refunds of expense	122	61	88	27	74	14
Climate change and emissions management	60	30	47	17	28	19
Miscellaneous	528	250	207	(43)	212	(5)
	1,003	**488**	**550**	**62**	**495**	**55**
Total Revenue	**38,732**	**19,451**	**20,737**	**1,286**	**18,950**	**1,787**

OPERATING EXPENSE BY MINISTRY[a]

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Investing in Families and Communities						
Culture	162	81	89	8	70	19
Health	17,048	8,524	8,017	(507)	7,869	148
Human Services	4,246	2,069	2,163	94	2,061	102
Justice and Solicitor General	1,253	638	698	60	646	52
Municipal Affairs	433	267	245	(22)	257	(12)
Tourism, Parks and Recreation	162	81	77	(4)	77	-
Securing Alberta's Economic Future						
Education	6,210	2,974	3,028	54	2,933	95
Enterprise and Advanced Education[b]	2,680	1,341	1,354	13	1,356	(2)
Infrastructure	504	244	246	2	247	(1)
Service Alberta	243	113	102	(11)	109	(7)
Transportation	478	248	237	(11)	226	11
Treasury Board and Finance	1,381	631	683	52	611	72
Advancing World-leading Resource Stewardship						
Aboriginal Relations[b]	169	81	73	(8)	73	-
Agriculture and Rural Development	845	491	656	165	525	131
Energy	439	199	220	21	202	18
Environment and Sustainable Resource Development	478	239	216	(23)	212	4
International and Intergovernmental Relations	37	19	15	(4)	13	2
Other						
Executive Council	51	25	22	(3)	22	-
Legislative Assembly	122	61	51	(10)	64	(13)
Total Operating Expense	**36,942**	**18,326**	**18,192**	**(134)**	**17,573**	**619**

[a] 2012-13 six month Actual numbers have been restated to reflect the *Budget 2013* organization of government departments.

[b] Numbers have been restated to reflect a transfer of $2 million from Enterprise and Advanced Education to Aboriginal Relations.

DISASTER / EMERGENCY ASSISTANCE

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Agriculture and Rural Development	2	1	1	-	292	(291)
Environment and Sustainable Resource Development	-	-	97	97	188	(91)
Municipal Affairs	27	14	9	(5)	7	2
Unallocated	171	-	-	-	-	-
2013 Alberta flood assistance:						
Aboriginal Relations	-	-	1	1	-	1
Education	-	-	1	1	-	1
Environment and Sustainable Resource Development	-	-	5	5	-	5
Human Services	-	-	65	65	-	65
Municipal Affairs	-	-	279	279	-	279
Total Disaster / Emergency Assistance	**200**	**15**	**458**	**443**	**487**	**(29)**

CAPITAL AMORTIZATION

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Investing in Families and Communities						
Culture	3	2	1	(1)	1	-
Health	17	9	8	(1)	8	-
Human Services	11	6	5	(1)	4	1
Justice and Solicitor General	25	13	12	(1)	4	8
Municipal Affairs	30	15	15	-	14	1
Tourism, Parks and Recreation	18	9	9	-	8	1
Securing Alberta's Economic Future						
Education	3	2	2	-	2	-
Enterprise and Advanced Education	5	3	3	-	3	-
Infrastructure	102	51	41	(10)	41	-
Service Alberta	45	23	19	(4)	22	(3)
Transportation	435	218	222	4	201	21
Treasury Board and Finance	22	11	7	(4)	4	3
Advancing World-leading Resource Stewardship						
Agriculture and Rural Development	16	8	8	-	7	1
Energy	23	12	10	(2)	9	1
Environment and Sustainable Resource Development	37	19	16	(3)	14	2
Other						
Legislative Assembly	1	1	-	(1)	-	-
Total Amortization Expense	**795**	**402**	**378**	**(24)**	**342**	**36**

INVENTORY CONSUMPTION

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Investing in Families and Communities						
Culture	1	-	-	-	-	-
Health	47	24	19	(5)	18	1
Human Services	1	-	-	-	-	-
Securing Alberta's Economic Future						
Education	11	7	11	4	14	(3)
Infrastructure	77	39	19	(20)	30	(11)
Service Alberta	9	4	6	2	6	-
Transportation	40	6	6	-	-	6
Treasury Board and Finance	1	-	-	-	-	-
Advancing World-leading Resource Stewardship						
Environment and and Sustainable Resource Development	1	1	-	(1)	-	-
Total Inventory Consumption	**187**	**81**	**61**	**(20)**	**68**	**(7)**

DEBT SERVICING COSTS

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
General						
Agriculture and Rural Development						
Agriculture Financial Services Corporation	75	37	34	(3)	33	1
Treasury Board and Finance						
General government	315	157	140	(17)	142	(2)
Municipal Affairs						
Alberta Social Housing Corporation	12	6	6	-	7	(1)
	402	**200**	**180**	**(20)**	**182**	**(2)**
Capital Plan						
Education						
Alberta Schools Alternative Procurement P3 financing costs	27	13	14	1	12	2
Treasury Board and Finance						
Direct borrowing for capital purposes	144	72	50	(22)	25	25
Transportation						
Ring road P3 financing costs	67	34	31	(3)	31	-
	238	**119**	**95**	**(24)**	**68**	**27**
Total Debt Servicing Costs	**640**	**319**	**275**	**(44)**	**250**	**25**

2013-14 FINANCING REQUIREMENTS

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Financing Requirements / Completed to Date[a]						
Direct borrowing for capital purposes	3,190	1,596	1,747	151	-	1,747
Term debt borrowing for provincial corporations:						
Agriculture Financial Services Corporation	365	180	-	(180)	100	(100)
Alberta Capital Finance Authority	3,385	1,690	2,588	898	2,637	(49)
Alberta Treasury Branches	400	200	500	300	500	0
Total Financing Requirements / Completed to Date	**7,340**	**3,666**	**4,835**	**1,169**	**3,237**	**1,598**

[a] Does not include $1,247 million borrowed since September 30, 2013 ($120 million for AFSC; $150 million for ACFA; $977 million for capital purposes).

INVENTORY ACQUISITION

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Investing in Families and Communities						
Culture	1	-	-	-	-	-
Health	47	24	16	(8)	18	(2)
Human Services	1	-	-	-	-	-
Securing Alberta's Economic Future						
Education	12	6	10	4	12	(2)
Infrastructure	52	26	8	(18)	22	(14)
Service Alberta	9	4	6	2	5	1
Transportation	40	15	12	(3)	11	1
Advancing World-leading Resource Stewardship						
Environment and Sustainable Resource Development	1	1	-	(1)	-	-
Total Inventory Acquisition	**163**	**76**	**52**	**(24)**	**68**	**(16)**

Capital Plan Highlights

Capital Plan actual results for the first six months of 2013-14 were essentially on track with the overall estimate in *Budget 2013*.

- Actual six month Capital Plan spending was $2,417 million, $72 million lower than expected. While there are variances in most areas, these mainly reflect changes to timing of project progress. No projects have been cancelled.
- The $155 million increase in Transportation is mainly from accelerated progress on ring roads. The remainder of the changes reflect re-profiling of project cash flows both within the current year and from the 2012-13 fiscal year. These will likely adjust somewhat over the rest of 2013-14.
- Revenue for capital purposes was $55 million lower than estimated, mainly from fewer-than-anticipated applications from municipalities under the Federal Gas Tax Fund and to delayed Canada ecoTrust spending.
- Direct borrowing for the Capital Plan was $151 million higher than expected, due mainly to increased financing needs for projects re-profiled from 2012-13 and to market opportunities. The withdrawal from the Capital Plan financing account was consequently $169 million lower.

CAPITAL PLAN SUMMARY

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Capital Plan Spending	5,209	2,489	2,417	(72)	2,230	187
Capital Plan Financing						
Revenue received for capital purposes	522	217	162	(55)	165	(3)
Retained income of funds and agencies for capital purposes	84	42	42	-	5	37
Disposal of capital assets	2	1	2	1	1	1
Alternative financing (P3s)	344	172	172	-	132	40
Direct borrowing	3,190	1,596	1,747	151	-	1,747
Withdrawal from Capital Plan financing account	1,067	461	292	(169)	-	292
Transfer from Contingency Account	-	-		-	1,927	(1,927)
Total Capital Plan Financing	**5,209**	**2,489**	**2,417**	**(72)**	**2,230**	**187**

CAPITAL PLAN BY MINISTRY

(millions of dollars)

	2013-14				2012-13	
	Budget	6 Month Estimate	6 Month Actual	Change from Estimate	6 Month Actual	Change
Investing in Families and Communities						
Culture	54	27	11	(16)	7	4
Health	104	35	8	(27)	6	2
Human Services	10	5	4	(1)	6	(2)
Infrastructure (health facilities)	576	150	142	(8)	172	(30)
Justice and Solicitor General	87	44	17	(27)	50	(33)
Municipal Affairs	921	882	856	(26)	854	2
Tourism, Parks and Recreation	19	9	4	(5)	5	(1)
Transportation (municipal support)	751	180	153	(27)	195	(42)
Securing Alberta's Economic Future						
Education	564	268	270	2	169	101
Enterprise and Advanced Education	68	31	2	(29)	7	(5)
Infrastructure	214	60	96	36	83	13
Service Alberta	41	5	11	6	6	5
Transportation	1,409	524	679	155	595	84
Treasury Board and Finance	29	14	23	9	3	20
Advancing World-leading Resource Stewardship						
Agriculture and Rural Development	34	26	26	-	28	(2)
Energy	197	163	104	(59)	43	61
Environment and Sustainable Resource Development	126	63	10	(53)	6	4
Other						
Legislative Assembly	5	3	-	(3)	-	-
2013 Alberta flood assistance	-	-	1	1	-	1
Total Capital Plan	**5,209**	**2,489**	**2,417**	**(72)**	**2,235**	**182**

ECONOMIC OUTLOOK

Population surges as strong expansion continues

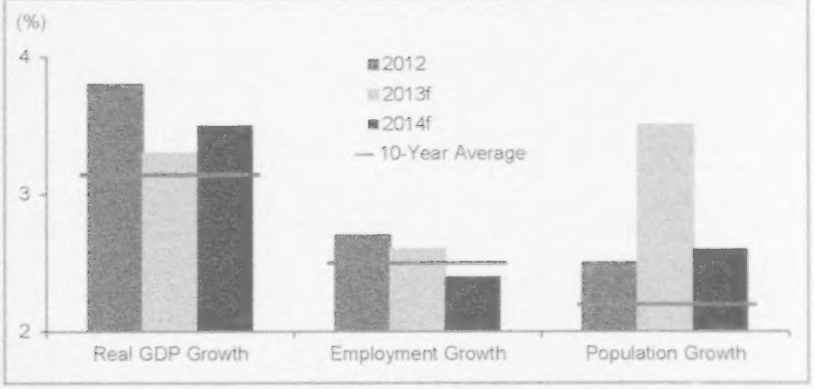
The Alberta economy continues to charge ahead, with few signs of slowing in the short term. The province is set to be among Canada's growth leaders again in 2013. Real GDP is now expected to expand by 3.3% this year (Figure 1), up from the forecast at *First Quarter* and *Budget 2013*. This comes after Alberta led all provinces in employment and real GDP growth in 2011 and 2012. Economic growth for 2014 has also been revised up since *Budget 2013* to 3.5%, mainly reflecting flood reconstruction activity.

The oil sector remains a key driver, with high levels of investment and large increases in production supporting economic growth.

A thriving labour market has lured people to Alberta in droves; 105,200 net migrants landed in Alberta during census year 2013. This has spurred construction and consumer spending, while keeping wage growth contained.

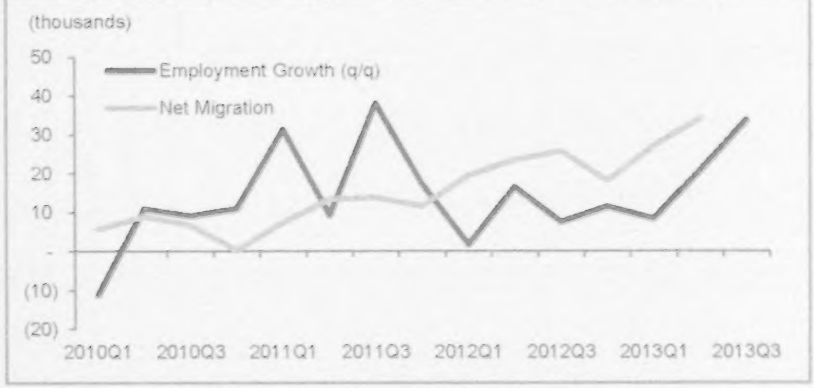
Another key development has been the southern Alberta floods. The floods resulted in extensive property damage, as well as supply disruptions in June and July. However, in terms of economic activity, spending on reconstruction is expected to boost employment, wages and real GDP in 2013 through 2015.

FIGURE 1. Forecast for Alberta Indicators



Sources: Statistics Canada and Alberta Treasury Board and Finance

FIGURE 2. Alberta Employment Growth and Net Migration



Source: Statistics Canada. (q/q is quarter-over-quarter)

Alberta Household Sector

Population leaps past 4 million

Alberta is now home to over 4 million people, thanks to a 3.5% jump in the population during the census year ending July 1, 2013. The province has not seen growth of this magnitude since 1981. In 2014, the population is expected to expand at a solid, albeit more moderate, pace of 2.6%.

Job growth picks up, labour market stays balanced

Job opportunities have attracted people to Alberta. Employment growth has been stronger-than-expected, and is now forecast at 2.6% in 2013, roughly matching last year's pace. Growth accelerated in the third quarter of 2013, with 33,800 jobs added. Normally job growth of this magnitude would result in a large dip in the unemployment rate; however, the surge in population has helped keep the labour market balanced (Figure 2). The unemployment rate has stayed in the 4.3% to 5.0% range this year, and job vacancies have held fairly steady. Likewise, pressure on weekly earnings have been contained. The forecast for primary household income, a driver of personal income tax revenues, is roughly unchanged from the *First Quarter* at 6.0%; however, it is up from the *Budget 2013* forecast of 5.4% on stronger-than-expected job growth.

Housing bucks national trend

Alberta is on pace to see another increase in residential investment in 2013 and again in 2014. The housing market has tightened this year, with the sales-to-new listing ratio rising, and the number of new unoccupied homes trending lower. New migrants and the

ECONOMIC OUTLOOK

Alberta floods have buoyed housing demand and allowed Alberta to buck the national slowing trend in housing.

Consumers in the drivers seat

Spending by households accounted for about a third of Alberta's economic growth last year. Households will make another solid contribution this year, thanks to record in-migration and a strong labour market. Real consumer spending is forecast to increase by 4.9% in 2013 and by 4.1% in 2014. A major contributor has been vehicle purchases. Historically volatile, vehicle sales have been persistently strong in Alberta. Some of the recent strength is likely due to flood-damaged vehicles being replaced. Consumers are spending in a low inflation environment; inflation has averaged only 1.4% so far this year.

Alberta Business Sector

Oil price forecast revised higher

World oil prices increased markedly over the summer due to Middle East tensions, particularly in Syria. While an easing of tensions has caused prices to retreat, the North American oil price (WTI) has remained above levels forecast at *Budget 2013*. Moreover, additional pipeline capacity between Cushing, OK and the US Gulf Coast has reduced the gap between the world Brent price and WTI since early 2013. As a result, the WTI forecast has been upgraded to US$98.96/bbl for this fiscal year. The differential between Alberta's heavy oil benchmark, Western Canada Select (WCS), and WTI remains highly volatile due to a lack of spare transportation capacity.

Loonie dips

The Canadian dollar has weakened against the US dollar since early 2013. Stronger US economic news has raised expectations that the Federal Reserve will taper its Quantitative Easing program. Meanwhile, the Bank of Canada has signalled a softer stance on interest rate increases. Both developments have contributed to the Canadian dollar weakening and a lower exchange rate forecast of US¢97.5/CDN$ for 2013-14.

Exports rebound

Stronger oil prices over the summer have provided a boost to the value of Alberta's international exports. Energy exports, which comprise about two-thirds of Alberta's total, jumped 17% in the third quarter of 2013 over the same time last year. Higher prices have also lifted Alberta's manufacturing shipments, notably sales of refined petroleum products.

Production has also resumed after a series of supply disruptions in the spring, including refinery maintenance shutdowns and delays at oilsands facilities. Oil exports were disrupted by flooding in June, but have since bounced back. Amid ongoing pipeline constraints, an increasing amount of oil is now transported by rail. In the agriculture sector, growing conditions have been favourable, with production on pace to hit a new record in 2013 for a number of crops, including wheat and canola. Exports will remain a key driver of Alberta's economic growth in 2014, as bitumen production continues to ramp up.

Flood reconstruction having an impact

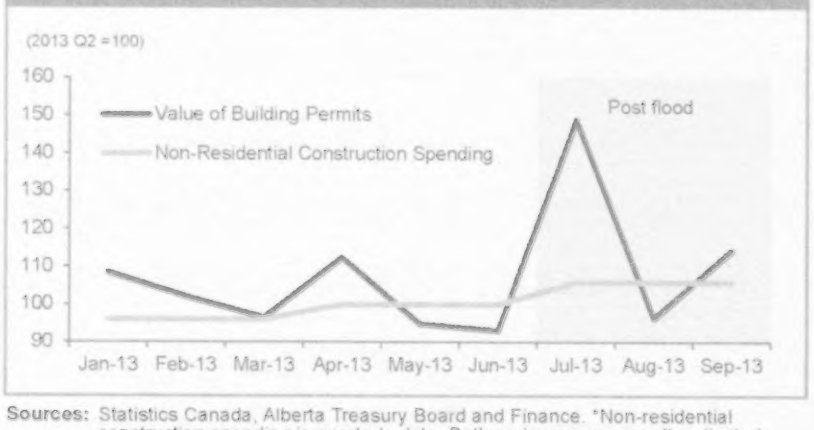
Reconstruction is lifting building activity. Calgary's building permits spiked the month after the flood (Figure 3), and non-residential construction accelerated in the third quarter. Flood reconstruction is expected to add to Alberta's economic growth in 2014 before gradually tapering in 2015 and beyond. With permits up 20% in the first three quarters of 2013, strong construction activity is expected to continue.

External Risks

Global economic conditions remain weak (see pg. 14). Alberta's outlook is subject to a number of external risks:

- With a lack of spare pipeline capacity, small transportation and refinery disruptions can result in large swings in the price of oil produced in Alberta.
- A further slowdown of emerging market economies would weigh on global demand and oil prices.
- Stronger-than-expected US economic growth remains the main upside risk to the forecast.
- A further drop in the Canadian dollar could provide a further boost to the value of Alberta exports.

FIGURE 3. Construction Indicators for Calgary*



Sources: Statistics Canada, Alberta Treasury Board and Finance. *Non-residential construction spending is quarterly data. Both series are seasonally adjusted.

Key Energy and Economic Assumptions

Fiscal Year Assumptions	2012–13 Actual	2013–14 6 Month Actual	2013–14 Fiscal Year Forecast		
			Budget	1st Quarter	2nd Quarter
Prices					
Crude Oil Price					
WTI (US$/bbl)	92.07	99.99	92.50	94.81	98.96
Alberta Wellhead (Cdn$/bbl)[a]	77.39	93.98	82.99	84.30	91.52
WCS @ Hardisty (Cdn$/bbl)	68.48	82.65	68.21	74.51	80.38
Natural Gas Price					
Alberta Reference Price (Cdn$/GJ)	2.29	2.81	3.07	3.14	2.97
Production					
Conventional crude oil (000s barrels/day)	556	578	550	592	588
Raw bitumen (000s barrels/day)	1,917	1,973[b]	2,140	2,160	2,138
Natural gas (billions of cubic feet)	4,223	2,073	3,873	3,882	3,938
Interest rates					
3-month Canada treasury bills (per cent)	0.96	1.00	1.05	1.05	1.00
10-year Canada bonds (per cent)	1.85	2.28	2.30	2.65	2.55
Exchange Rate (US¢/Cdn$)	99.9	97.0	99.0	98.0	97.5

Calendar Year Assumptions	2012	2013 Forecast			2014 Forecast	
		Budget	1st Quarter	2nd Quarter	Budget	2nd Quarter
Gross Domestic Product						
Nominal (millions of dollars)	311,898	321,561	326,837	331,859	339,028	348,452
per cent change	4.6	4.8	6.2	6.4	5.4	5.0
Real (millions of 2007 dollars)	288,548	293,288	294,392	298,359	301,720	308,831
per cent change	3.8	2.9	3.1	3.3	2.9	3.5
Other Indicators						
Employment (thousands)	2,150	2,190	2,197	2,205	2,227	2,257
per cent change	2.7	1.9	2.2	2.6	1.7	2.4
Unemployment rate (per cent)	4.6	4.5	4.6	4.6	4.3	4.4
Average Weekly Earnings (per cent change)	3.6	3.5	3.8	3.2	3.3	3.5
Primary Household Income (per cent change)	9.2	5.4	5.9	6.0	5.2	5.9
Net Corporate Operating Surplus (per cent change)	-10.4	5.9	6.3	7.9	10.3	4.3
Housing starts (number of units)	33,396	32,600	37,000	34,000	31,900	35,300
Alberta Consumer Price Index (per cent change)	1.1	1.8	2.0	1.8	1.8	2.0
Population (July 1st, thousands)	3,874	3,973	3,997	4,025	4,054	4,128
per cent change	2.5	2.6	3.2	3.5	2.0	2.6

[a] Refers to the average price per barrel of Alberta light, medium and heavy oil.

[b] Average bitumen production April - August 2013

REVENUE IMPACTS

Impact of recent developments on government revenue

Royalty revenue forecast edges higher

The revenue outlook for 2013–14 has been revised higher from *Budget 2013* and *First Quarter*, mainly reflecting a higher-than-forecast price environment.

Since *Budget 2013* and *First Quarter*, factors that have raised the royalty income forecast for 2013–14 include:

- A higher forecast for crude oil prices in North America (i.e., West Texas Intermediate) to US$98.96/bbl (Figure 1). The world price (i.e., Brent) has been supported by concerns of possible disruptions to Middle East supply, while the Brent-WTI differential has narrowed since early 2013.
- For 2013-14, there has been a downward adjustment to the forecast differential between WTI and the price Alberta oil sands producers receive for bitumen (i.e. Western Canada Select). This reflects strong demand for Alberta heavy crude, delays in oil sands projects reaching full production, and some alleviation of transportation constraints. Based on actual prices so far in 2013-14, this differential is now forecast at 21% of WTI, down from 23% at *First Quarter* and from 27% at *Budget 2013*.
- The forecast for the Canadian dollar has fallen marginally to 97.5 US¢/Cdn$, lower than the *Budget 2013* and *First Quarter* forecasts. A lower Canadian dollar boosts royalty revenue.

Despite stronger production, natural gas royalties have been adjusted downward slightly due to a lower forecast price, increased costs of processing gas, and higher costs of the Natural Gas Deep Drilling Program.

Alberta land sales continue to be projected lower than *Budget 2013* due to a lower price received per hectare and industry requesting less land be posted for sale.

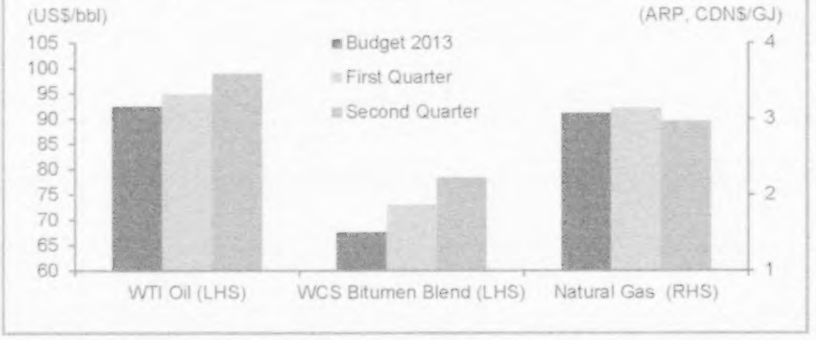
Income tax forecast improves slightly

Alberta's economy continues to perform well. Solid increases in wages and employment have buoyed household income. As a result, personal income tax revenue is expected to post another solid increase this fiscal year. The forecast for 2013-14 personal income tax revenue has been revised higher from *Budget 2013* based on continued strong 2012 preliminary tax assessment data, as well as an upgrade to the primary household income forecast.

The business sector is benefiting from Alberta's strong economic growth as well as stronger-than-expected energy prices. However, flood related losses and an upward revision to forecast wage growth is expected to limit overall growth in corporate profits in 2013, as measured by net corporate operating surplus. The forecast for 2013–14 corporate income tax revenue is up from *Budget 2013*, based on strong year-to-date cash collections.

There are several risks facing Alberta's government revenue forecast. On the downside, a reversal of the economic recovery in Europe or a further slowdown in emerging market growth could cause energy prices to slump. Pipeline project delays or a faster-than-anticipated increase in US oil production would also put downward pressure on energy prices. On the upside, increased supply disruptions in the Middle East or stronger-than-expected US economic growth could cause oil prices and incomes to rise.

FIGURE 1. Key Energy Price Assumptions for 2013–14



Source: Alberta Energy. ARP is the Alberta Reference Price

GLOBAL ECONOMY

The global recovery forever on the horizon

Global growth in the wake of the 2008-09 recession has failed to live up to expectations. In October, the International Monetary Fund (IMF) downgraded its 2013 forecast for the sixth consecutive time (Figure 1). Recent weakness has originated from emerging markets, where growth has slowed, as well as a stagnant Eurozone economy.

The IMF is not alone in downgrading its forecast. Many forecasters have repeatedly predicted growth to return to pre-crisis levels only to be disappointed when growth fails to meet expectations. For most economies, growth since 2010 has been well below the 2000-07 average and is trending downward (Figure 2). One possibility is that conditions are not as favourable as they once were, and forecasters have not adjusted to the new reality. A second possibility is that forecasters were correct to expect a rebound, but have not got the timing right. The slack in the economy cannot last forever, and when it is finally taken up, the long-predicted rebound in growth will occur. Both of these possibilities are explored below.

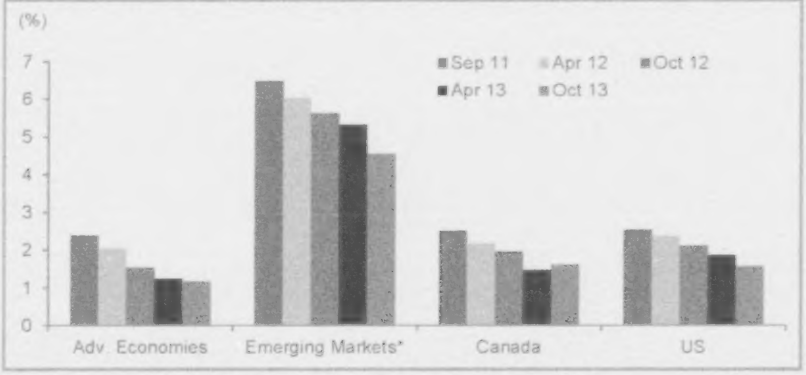
Emerging market growth downshifts

Emerging markets, both before and since the recession, have been drivers the global economy. However, growth in these economies has been weakening and may never again reach the lofty levels achieved in the 1990s and early 2000s. This may be a blessing in disguise. Emerging markets were able to achieve such high growth because they were in the early phase of development and had so much to gain. As their economies developed, additional gains were harder to achieve. China, for example, averaged 10.7% annual growth between 1991 and 2007. In each year since, growth has fallen below this mark, falling to a 13 year low of 7.8% in 2012. China was able to achieve such high rates of growth through urbanization, improved educational attainment and massive capital investment. Each of these factors is subject to diminishing returns, which may have contributed to the slower growth of late. Moreover, in the face of weak demand in advanced economies, Chinese growth has rotated away from exports and investment, and towards domestic consumption. This rebalancing has hurt overall growth in emerging markets, but provides the global economy with a much-needed source of demand going forward.

Baby boomers are exiting the labour force

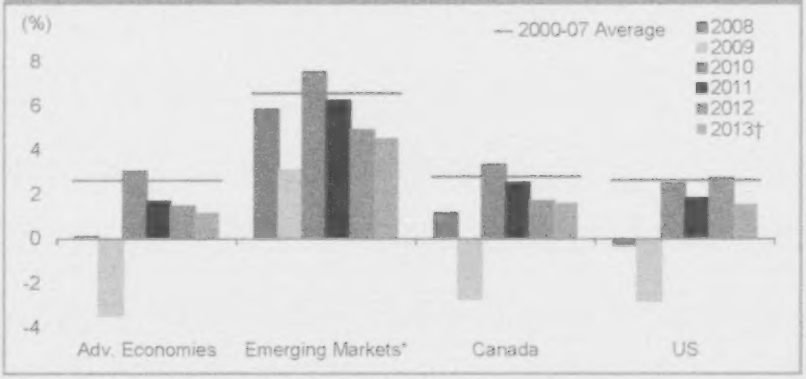
Advanced economies have benefited from an expanding labour force made possible by greater labour force participation among women and by baby boomers reaching their prime

FIGURE 1. 2013 Real GDP Growth Forecast by Date



Source: International Monetary Fund

FIGURE 2. Real GDP Growth



Source: International Monetary Fund

GLOBAL ECONOMY

working years. The participation rate, the share of the working-age population employed or actively seeking work, rose as a result, allowing for more growth than if the rate was unchanged. Going forward, the participation rate for women will not contribute as much to growth, as it has largely converged to that of men. Moreover, now that baby boomers are beginning to retire, a major source for growth will start to detract from it.

This trend is unfolding in the U.S. The participation rate has been declining since 2000, recently falling to a 30-year low (see Figure 3). A lower participation rate helps explain why the employment-to-population ratio has barely budged despite the unemployment rate falling 2.7 percentage point from its recessionary peak. More people are working, but the labour force makes up a smaller share of the total population.

Aging is does not fully explain the drop in the US participation rate. The recession induced many to leave the labour force. These people will likely return as conditions improve. However, increasing labour force participation can no longer be counted on to deliver growth like it did in the past.

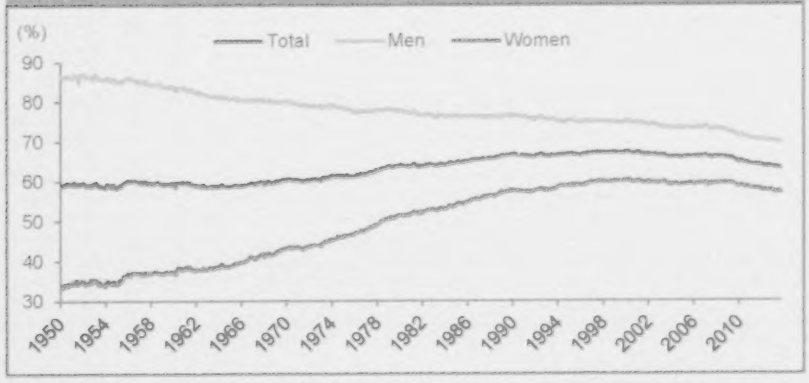
Cyclical factors matter too

Not all the weakness in global growth is due to structural changes. The importance of the economic cycle is highlighted by inflation, which has declined steadily throughout most of the advanced world since 2011. Weak price growth is a symptom of weak demand, the return of which would increase both output growth and inflation.

In the latest data, year-over-year inflation was 1.1% in Canada, 0.9% in the U.S. and 0.7% in the Euro Area. In Canada's case, inflation has trended downwards since May 2011, and has been below the Bank of Canada's 2% inflation target since April 2012. Over this period, the Bank's inflation forecasts have been repeatedly revised down (Figure 4).

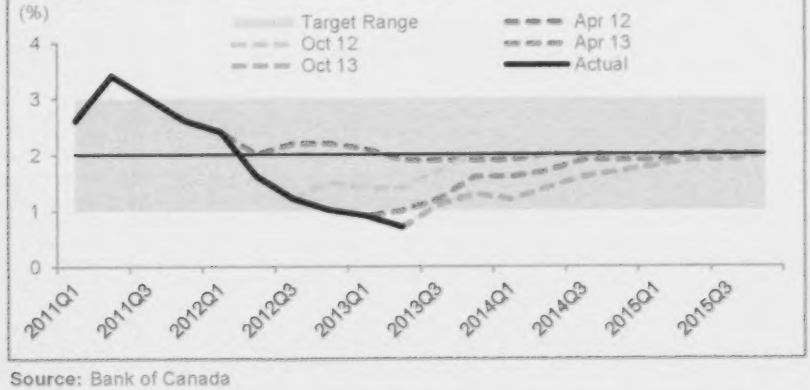
No country has struggled with deflation and weak growth more than Japan for much of the last 20 years. Nevertheless, Japan is one of few advanced economies where inflation has been increasing, thanks to aggressive policy actions. Over the last year, Japan has undertaken unprecedented monetary stimulus supported by stepped-up fiscal stimulus. Though still only 1.0%, Japanese inflation has jumped 1.9 percentage points since March. The added stimulus has also impacted real GDP growth, which has averaged 3.3% (annualized) over the first three quarters of 2013. Japan is one of few countries for which the IMF has increased its 2013 growth forecast.

FIGURE 3. US Labour Force Participation Rate



Source: US Bureau of Labor Statistics

FIGURE 4. Bank of Canada Inflation Forecasts



Source: Bank of Canada

Conclusion

The global economy has been slow to come out of the 2008-09 recession. Elevated unemployment and low inflation are evidence of weak demand. When demand improves, so too will growth. However, some of the engines of growth during the past 50 years have been running out of steam. China cannot sustain double-digit growth indefinitely, and the baby boomers are leaving the labour force in growing numbers. Unless new sources of growth emerge, growth will likely be lower than in the past.